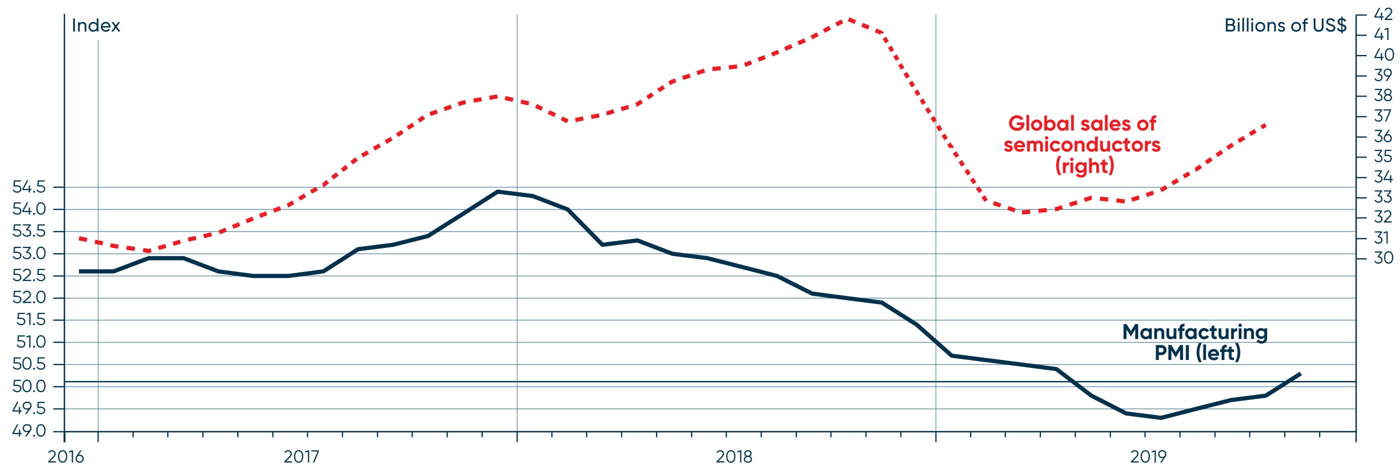
Investment Strategy

World

While talks between China and the United States in the trade war opposing the two countries seem to be making headway, the damage to the global economy has been considerable. Protectionist policies implemented in the last two years left several major economies in difficulties. The world economy is on track to grow this year at the slowest pace in a decade. Given the growing uncertainty, a majority of central banks have opted to ease their monetary policy in Q3, a record high since the global recession of 2008–2009. Yet, global equities reached a record high during the fourth quarter. This performance has been supported by signs of improvements in the global economic backdrop. The J.P. Morgan Global Manufacturing PMI swung back into expansion territory in November at a seven-month high. Another positive development in the world economy is firming global sales of semiconductors. All in all, the improving geopolitical backdrop and the degree of monetary stimulus provided by the world's central banks in recent months should be enough for the global economy to accelerate in 2020 (3.2% vs. 3.0% in 2019).

World: Global economy stabilizing?
JPMorgan Global Manufacturing PMI and global sales of semiconductors



NBF Economics and Strategy (Data via Bloomberg)

In this issue

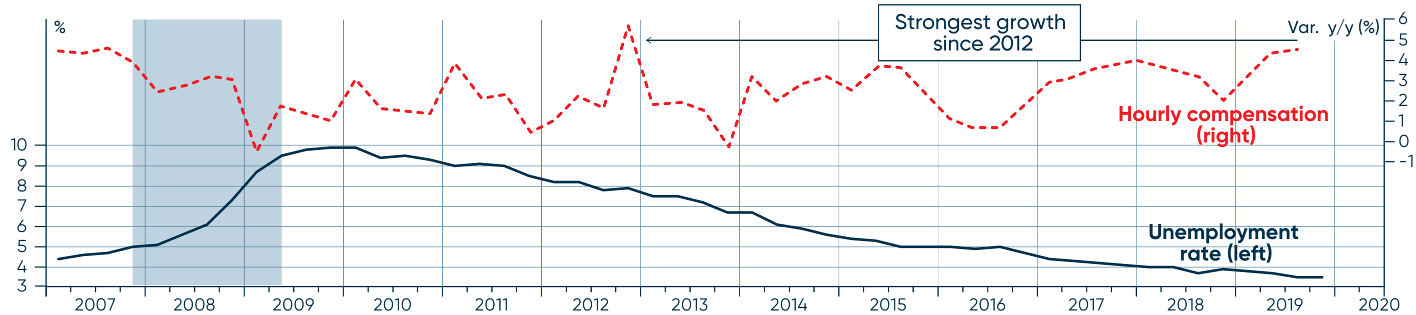
NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

United States

In the U.S., the longest growth streak in history showed signs of losing steam in 2019, reviving fears of recession in the present context of strained international trade relations. In our opinion, a recession should be avoided as a truce remains the most likely scenario in light of the coming U.S. presidential election. Moreover, the resilience of consumption is largely compensating for the weakness of foreign trade, which is putting the brakes on business investment. Propping up consumers is the buoyant labour market, which has created roughly two million jobs in a year. With the jobless rate close to 50-year lows, hourly compensation continues to pick up steam. Decline in mortgage rates contributed to a rebound in activity in the housing sector. By lowering interest rates in October after twice doing so this summer, the Federal Reserve has contributed to set the yield curve back on an upward slope after its inversion in 2019 had raised alarm bells. This rate adjustment should do for now. With the 2020 election in the offing, we can expect both monetary and budgetary policy to remain accommodative. We expect U.S. GDP to grow by 2.3% and 1.9% in 2019 and 2020, respectively.

U.S.: Workers benefiting from labour shortage

Unemployment rate and hourly compensation in the non-farm business sector



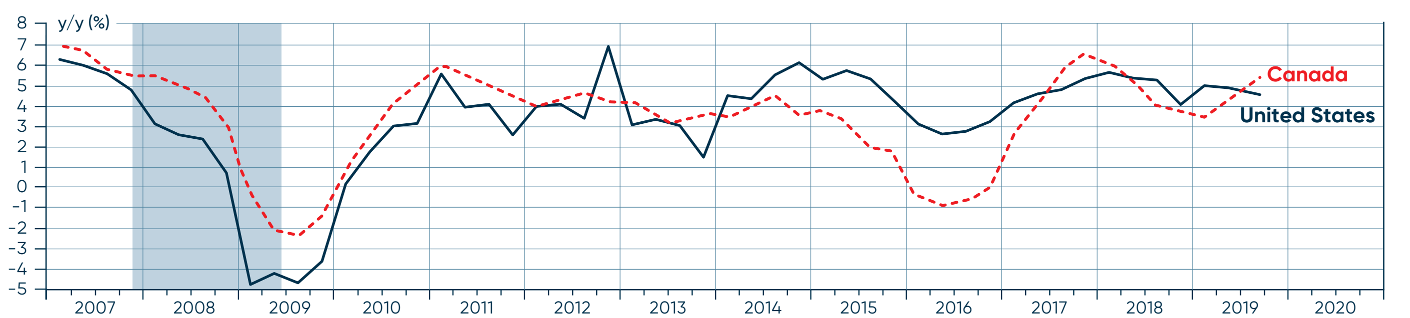
NBF Economics and Strategy (Data via Refinitiv)

Canada

Newly revised GDP data suggest the Canadian economy is in better shape than previously thought. A blistering Q2 was followed by a decent third quarter, putting Canadian output on track to expand by roughly 1.7% in 2019. We are encouraged by the large upward revision to the savings rate and strong growth in wages and salaries. For the first time in 18 months, this all-important component of labour income grew more from a year earlier in Canada than in the U.S.—5.1% vs. 4.6%. It is encouraging to note that the growth of Canadian wages and salaries is broad-based among regions, with only the Prairies trailing the U.S. national rate. This development suggests resilience for the Canadian economy as a whole in the months ahead, the more so since the federal government announced a tax cut for the middle class. This should allow economic growth to reach 1.8% in 2020. As such, barring a significant deterioration in the global economic outlook, we continue to expect the central bank to refrain from cutting interest rates over the near to medium term, especially since core inflation has been close to target for some time.

Canada: Sharp increase in wage bill over the past year

Year-on-year changes in wages and salaries, Canada vs. U.S.



NBF Economics and Strategy (Data via Statistics Canada and Refinitiv)

Investment Strategy

Following a brief period of turbulence in early October, global risk assets resumed their upward path over the rest of the fourth quarter, lifted in part by improving economic indicators as well as growing evidence that Chinese and U.S. negotiators were closing in on an interim trade agreement. The end result? An especially fruitful year for investors standing in sharp contrast to 2018, as nearly all asset classes generated positive returns.

That said, it is important to caution investors that a repeat of returns earned this past year is far from likely in 2020. Indeed, let us not forget that a large fraction of markets' gains over the past twelve months were, in fact, a recovery from the substantial losses incurred at the end of 2018. Furthermore, current levels of equity valuations and earnings growth suggest modest returns should be expected for major bourses as we begin the new decade. Nevertheless, the stock market outlook still compares favourably to bonds, as a recent de-escalation of trade tensions, an accumulation of economic green shoots, as well as a majority of central banks throughout the world turning more accommodative over the past few quarters all bode well for risk assets. Under these circumstances, we decided early last quarter to modestly increase our equity positioning at the expense of fixed-income products.

Further bolstering our constructive economic outlook is the case of the U.S. consumer, the cornerstone of the U.S. economy. Sentiment surveys continue to indicate that consumers are doing well and remain confident about the future with main measures firmly anchored near historic highs. Contributing to these upbeat readings is a highly favourable labour market for workers, characterized by a surplus of jobs openings and steadily rising wages. We should also mention the health of household finances, with the amount of debt relative to GDP having significantly shrunk since the last recession and debt servicing from disposable income now standing at a 40-year low. All in all, these circumstances suggest that the current business cycle has room to run.

Outside the U.S., we scaled back our Canadian equities position and added to the Europe, Australasia, and Far East (EAFE) region in light of recent changes in market trends. Beyond price action, the S&P/TSX's propensity to relatively better absorb shocks in times of trade tensions is, in our view, not as much of a necessity now. As for developed market equities outside North America, while weaker growth persists, upside remains should international trade begin to pick up again.

Moving on to the topic of currencies, this past quarter was a somewhat tumultuous one for our very own Canadian dollar. Indeed, a series of contradicting monthly job reports and tone changes from the Bank of Canada led the loonie to travel from the top to the bottom of its recent trading range over the course of the last three months. While the end result was an exchange rate nearly unchanged quarter over quarter, these variations did allow us to book profits on our previously overweight loonie position. Looking ahead, the evolution of interest rate differentials between the U.S. and Canada should support our dollar, but we do not expect any major upward movement unless global growth accelerates faster than currently expected.

MODEL PORTFOLIOS

Income Portfolio

Investor Profile: You want to preserve your capital or establish a source of periodic income to finance ongoing expenses. You do not find the stock market very attractive because of its volatility, but you are not against the idea of investing a small part of your portfolio in stocks, mainly to counteract the effects of inflation. Your tolerance for risk is low.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	5.0%	0.0%
Fixed income (duration: 6.75 years)[1]	60% to 100%	70.0%	67.5%	-1.5%
Canadian equities	0% to 30%	8.0%	9.0%	0.0%
U.S. equities		8.0%	10.0%	1.0%
Foreign equities		4.0%	3.5%	0.5%
Alternative investments[2]	0% to 20%	5.0%	5.0%	0.0%

Conservative Portfolio

Investor Profile: On the whole, you want your portfolio invested in fixed-income securities. Although you can tolerate limited volatility to ensure that your assets will grow, you prefer having a portfolio consisting mainly of fixed-income investments for reasons of stability. Your tolerance for risk is low.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	5.0%	0.0%
Fixed income (duration: 6.75 years)[1]	45% to 80%	55.0%	53.0%	-1.0%
Canadian equities	20% to 45%	14.0%	15.0%	-0.5%
U.S. equities		14.0%	16.0%	0.5%
Foreign equities		7.0%	6.0%	1.0%
Alternative investments[2]	0% to 20%	5.0%	5.0%	0.0%

Balanced Portfolio

Investor Profile: You give equal importance to achieving growth in your investments and receiving income. You can tolerate moderate changes in market value to ensure growth, but you prefer having a mix of fixed-income investments and equities for reasons of stability.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	5.0%	5.0%	0.0%
Fixed income (duration: 6.75 years)[1]	30% to 65%	40.0%	37.5%	-0.5%
Canadian equities	30% to 65%	18.0%	19.0%	-1.0%
U.S. equities		18.0%	20.5%	0.5%
Foreign equities		9.0%	8.0%	1.0%
Alternative investments[2]	0% to 25%	10.0%	10.0%	0.0%

Growth Portfolio

Investor Profile: Your main goal is capital growth. Although you can tolerate greater volatility in order to increase the value of your assets, you are not prepared to invest your entire portfolio in stocks. Your tolerance for risk is high.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 25%	5.0%	5.0%	0.0%
Fixed income (duration: 6.75 years)[1]	20% to 45%	30.0%	28.0%	-1.0%
Canadian equities	40% to 75%	22.0%	23.0%	-0.5%
U.S. equities		22.0%	24.0%	0.5%
Foreign equities		11.0%	10.0%	1.0%
Alternative investments[2]	0% to 25%	10.0%	10.0%	0.0%

Maximum Growth Portfolio

Investor Profile: You want to maximize the eventual return on your capital by investing all or most of your portfolio in the stock market. In doing so, you accept higher volatility of your investment returns in the hope that these returns will ultimately be higher. Your tolerance for risk is high.

Asset Class	Minimum/ Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 30%	5.0%	5.0%	0.0%
Fixed income (duration: 6.75 years)[1]	0% to 30%	15.0%	13.5%	-0.5%
Canadian equities	55% to 100%	26.0%	27.0%	-0.5%
U.S. equities		26.0%	28.0%	0.5%
Foreign equities		13.0%	11.5%	0.5%
Alternative investments[2]	0% to 30%	15.0%	15.0%	0.0%

1 FTSE TMX Canada Universe Index
2 Includes Hedge funds, global infrastructure and gold

FORECAST

			Forecast	
	2018	2019	2020	2021
Gross Domestic Product %				
Canada	2.0	1.7	1.8	2.0
U.S.	2.9	2.3	1.9	2.0
Inflation %				
Canada	2.3	2.0	2.2	2.1
U.S.	2.4	1.8	2.3	2.3

	December 2019		June 2020		December 2020	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Rate %						
Short-term rates (T-Bills, 91-Day)	1.66	1.56	1.67	1.53	1.67	1.53
10-year bond yields	1.58	1.85	1.85	2.02	2.05	2.18
30-year bond yields	1.67	2.28	1.93	2.44	2.12	2.60
Canadian dollar	US $1.30		US $1.30		US $1.34	